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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

STATE OF NEW YORK,

Petitioner,

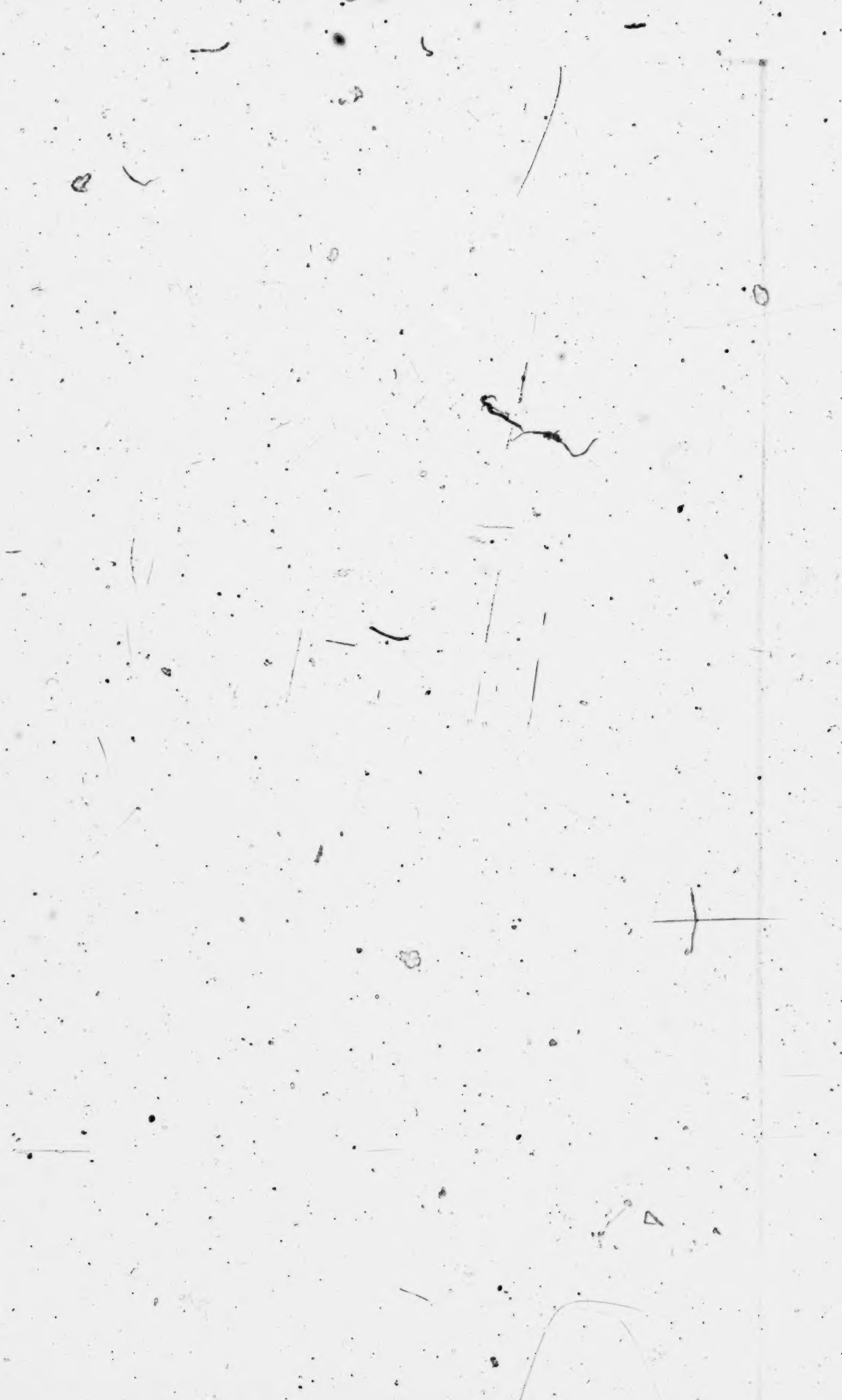
vs.

LEONARD H. CARTER, AS TRUSTEE IN BANKRUPTCY

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York;
WENDELL P. BROWN,
Solicitor General of the State of New York,
Counsel for Petitioner.



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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

IN THE MATTER OF

UNION FABRICS, INC.,

Bankrupt,

STATE OF NEW YORK

Petitioner,

vs.

LEONARD H. CARTER, TRUSTEE IN BANKRUPTCY,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

May it Please the Court:

The Petitioner, State of New York, respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc. on December 20, 1939, and said corporation was thereafter adjudged a bankrupt (R. 4). Leonard

H. Carter was hereupon appointed trustee in bankruptcy and is still acting as such.

Thereafter, and within the time prescribed by statute, the New York State Tax Commission filed a claim in this proceeding for franchise taxes under Article 9-A of the Tax Law of the State of New York, in the amount of $1,403.14, verified May 29, 1940, for the years 1936, 1937 and 1938, and the Industrial Commissioner filed a claim for unemployment insurance taxes covering the period January 1, 1936 to October 28, 1939, in the sum of $257.78, verified June 4, 1940. There is no dispute as to the amount of these taxes (R. 29).

By notices dated July 1 and July 2, 1946, the trustee filed objections to demands for interest on these tax claims beyond the date of the filing of the petition in bankruptcy (R. 5). After hearings, the referee on January 24, 1947, filed his findings of fact and conclusions of law based thereon, overruling the trustee's objections to the allowance of interest to the date of payment (R. 5). Upon a petition by the trustee and an order to show cause based thereon, dated February 6, 1947, the hearings with respect to the objections as to interest were reopened before the referee on February 13, 1947 (R. 5). The trustee thereupon attempted to offer evidence with respect to certain actions and proceedings taken by him against the former president of the bankrupt, which resulted in the receipt of the sum of $30,000 from the former president of the bankrupt in settlement of said claim (R. 5-8; 33-38). The referee sustained objections to this offered proof (R. 38), and granted the allowance of interest on said tax claims to the date of payment (R. 29).

The trustee applied to the United States District Court for the Southern District of New York for a review of the order of the referee. The petition to review was granted and the order of the referee allowing interest to the date of payment of these tax claims and sustaining the objec-

tions to the trustee's offer of the proof, referred to above, was reversed (R. 17-19).

An appeal from the order of the District Court was taken by the State of New York to the Circuit Court of Appeals for the Second Circuit. Although two of the three Circuit Court judges who heard this case did not agree with the decision of the District Court, and were of the opinion that interest on tax claims should be allowed to the date of their payment (R. 41-44), the court affirmed the order of the District Court (R. 45) in view of the fact that, on the same day the opinion of the court in the instant case was handed down, the Circuit Court also handed down a unanimous opinion in *Saper* v. *City of New York*, — F. (2d) —, holding tax claims of the City of New York to be entitled to carry interest only to the date of the filing of the petition in bankruptcy. Since the opinion in the *Saper* case has not been officially reported at the time of the preparation of this petition and is not contained in the transcript of the record, we are attaching a copy thereof to this petition for the convenience of the Court.

Of the five judges who were concerned with these two cases, three were of the opinion that tax claims are entitled to carry interest to the date of the filing of the petition only, while two judges were of the opinion that such claims bear interest to the date of payment. The two judges who were of the opinion that the order of the District Court should be reversed in the instant case felt bound by the opinion of the three judges who sat in *Saper* v. *City of New York*, *supra*.

The majority view, as expressed in the *Saper* case, which was considered binding in the instant case, was that by the Chandler Act amendments of 1938, taxes were classified as "debts" within § 64, subd. a of the Bankruptcy Act (11 U. S. C. A. § 104, subd. a), and that § 57, subd. n of the Bankruptcy Act (11 U. S. C. A. § 93, subd. n) was broadened

to include all tax claims and requires them to be proved and filed in the manner provided in that section, and furthermore, that § 57 provides that a proof of claim shall state, among other things "that the claim is justly owing from the bankrupt to the creditor." From these amendments, the court reasoned, it is apparent that tax claims are to be treated as debts and that the sovereign, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. The court concluded that by reason of these changes tax claims were taken from their former favored position. The court saw no reason to suppose that these changes did not place tax claims in the same situation as other debts with respect to interest also.

The two judges in the instant case, who were of the opinion that the order of the District Court should be reversed, took the view that since tax claims were accorded interest to the date of payment prior to the Chandler Act amendments, clear and specific Congressional intent to change the rule is required, but that no such intent is apparent (R. 44, 45).

Petitioner seeks a review by certiorari in this Honorable Court to determine whether, in a bankruptcy proceeding, interest on claims of the State of New York for franchise and unemployment insurance taxes should be allowed to the date of their payment or to the date of the filing of the petition only.

Questions Presented

The questions which are presented for review are:

1) Is the State of New York entitled to interest on its tax claims against a bankrupt estate to the date of the payment of the claim?

2) Is evidence of extensive litigation between the trustee and the bankrupt's former president, tending to show the reason why the estate was not closed on an earlier date,

sufficient to warrant the denial of interest on such claims to the date of payment?

Reasons Relied Upon For Allowance of the Writ

The following are respectfully submitted by your petitioner and relied upon as reasons for granting of the writ:

a) The act of the Circuit Court of Appeals for the Second Circuit in holding that tax claims carry interest to the date of the filing of the petition in bankruptcy only, and not to the date of the payment of the claim, is directly contrary to the holding of the Circuit Court of Appeals for the First Circuit upon the same question in *Davie* v. *Green*, 133 F. (2d) 451.

b) There is a wide divergence of opinion among the Circuit Judges for the Second Circuit upon this question, since two of the three judges in the instant case were of the opinion that the State is entitled to interest on its tax claims to the date of payment, while the three judges who heard the case of *Saper* v. *City of New York*, decided on the same day, were of the opinion that tax claims carry interest to the date of the filing of the petition only.

c) The decision of the Circuit Court of Appeals for the Second Circuit is of public interest and affects the administration of bankrupt estates throughout the country and presents a fundamental question of law upon which there should be no diversity of opinion in the various Federal courts of the country; the uncertainty created by this conflict adversely affects the expeditious administration and closing of innumerable pending bankruptcy cases, and will continue to do so unless and until this court shall exercise its power of supervision and hear and determine the questions presented.

Petitioner understands that the United States of America also intends to file an application for certiorari in this case as it relates to the judgment of the Circuit Court disallowing interest on its tax claims to the date of payment, and the State of New York supports such petition.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 20909, *Leonard H. Carter, Trustee of Union Fabrics, Inc., Bankrupt, Trustee-Appellee* v. *United States of America and State of New York, Claimants-Appellants,* and that the said judgment of the Circuit Court of Appeals in the Second Circuit may be reviewed by this Court as prayed for by petitioner, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Dated, July 13, 1948.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York;
By: WENDELL P. BROWN,
Solicitor General of the State of New York,
Attorney for Petitioner.

APPENDIX

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 267—October Term, 1947.

(Submitted May 3, 1948—Decided May 25, 1948).

Docket No. 20977

LEWIS H. SHAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC., *Petitioner-Appellant,*

v.

THE CITY OF NEW YORK, *Respondent-Appellee.*

Before: L. HAND, SWAN and CLARK, *Circuit Judges*

Appeal from the District Court of the United States for the Southern District of New York.

Petition by Lewis H. Saper, as trustee of Spotlight Productions, Inc., bankrupt, for review of an order of a referee in bankruptcy refusing to expunge the claim of the City of New York against the bankrupt for sales and business taxes and ordering the payment of the claim, together with interest at the rate of one per cent per month until the date of payment. From an order affirming the order of the referee, D.C., S. D. N. Y., 75 F. Supp. 458, the petitioner appeals. Order affirmed as to the principal of the taxes, but reversed as to the interest.

DAVID HAAR,
of New York City,
for appellant;

JOHN P. McGRATH,
Corp. Counsel, of New York City
(Isaac C. Donner, Bernard H. Sherris, and Leroy Mandle, all of New York City, of counsel), for appellee.

CLARK, *Circuit Judge:*

The first point on this appeal concerns the validity of a claim against an estate in bankruptcy for certain sales and business taxes levied by the City of New York against the bankrupt. The trustee concedes the validity of such taxes as were levied upon the bankrupt's sales of machinery manufactured by it, but contests the tax levied on its purchases of materials. But, as stated in the opinion below, D. C. S. D. N. Y., 75 F. Supp. 458, this is directly contrary to the law and the rulings under it. It is quite settled that both seller and purchaser may be held liable for the city sales tax, though in fact it is primarily imposed upon the purchaser, who must pay it to the City Treasurer if he has failed to pay it to his vendor. § N41-2.0, subds. e, f, of the Administrative Code, New York City. *Kesbeck, Inc.* v. *McGoldrick*, 278 N.Y. 293, 297, 16 N.E. 2d 288, 119 A. L. R. 536, reargument denied 278 N.Y. 716, 17 N. E. 2d 136; *Fifth Ave. Bldg. Co.*, v. *Joseph*, 272 App. Div. 449, 71 N. Y. S. 2d 566; *City of New York* v. *Feiring*, 313 U.S. 283. The liability of the estate is clear.

The other point, however, the liability of the estate for interest upon these tax claims after bankruptcy and until they are paid, is interesting, important, and difficult. Both the referee and the district court have allowed interest, at the high rate provided by the local code of one per cent per month, so that the accumulating interest is fast approaching the face of the claim.[1] The decision must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof. The matter has been in dispute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed

[1] The tax period involved was Nov. 1, 1940 to May 31, 1942; the petition in bankruptcy was filed Jan. 5, 1944, and the City's claim originally on May 19, 1944; the referee's order of allowance was made on July 18, 1947. In that order he allowed a sales tax of $495.61, with interest to date of $341.97, and a business tax of $19.72, with interest of $13.13, and made express provision for additional interest at the rate of 1% per month until payment.

that Judge Coxe's decision, D. C. S. D. N. Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davie* v. *Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, e.g., *In re Flarton*, D. C. E. D. N. Y., 42 F. Supp. 1002; and *cf. In re L. Gendolfi & Co.*, D. C. S. D. N. Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *In re Union Fabrics*, D. C. S. D. N. Y., 73 F. Supp. 685, the appeal from which is decided herewith,[2] with the writer of this opinion alone of the court there sitting in agreement with Judge Bright. Our decision herein was perhaps somewhat foreshadowed by the remarks of Judge L. Hand in *Hammer* v. *Tuffy*, 2 Cir., 145 F. 2d 447, 449, leaving the question open, and by those of Judge Swan in *United States* v. *Roth*, 2 Cir., 164 F. 2d 575, pointing out that under the recent congressional enactments tax claims were treated substantially as debts of the bankrupt. It is in accord with the views of text writers, notably Messrs. Moore and Oglebay, 3 Collier on Bankruptcy, 14th Ed. 1941, par. 63.16, reiterated in 1946 Com. Supp. 131, 132, also Mr. Oglebay in 17 J. N. A. Ref. Bankr. 127, 129, 130, 21 *id.* 106, 107, 22 *id.* 41, and the commentator in 61 Harv. L. Rev. 354.

For reasons both of administrative convenience and of fundamental justice and equity it has been steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration. *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit. supra*.[3] A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D. C. N. D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D. C. N. J., 148 F. 907, held to the contrary.

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[2] *Carter, Trustee* v. *United States, et al.*, 2 Cir., — F. 2d —.

[3] If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*.

But the Kallah case set the pattern and was followed by other cases, including *In re J. Nemist & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that "the court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors." § 64a, 11 U. S. C. A. § 104 (a) (before amendment). Hence the trustee was, in effect, compelled to search them out. So taxes were in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

In 1926, however, § 64a was amended, by adding the words "in the order of priority as set forth in paragraph (b)"; and of the seven priorities provided in (b), taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64b spoke of the debts "to have priority" in advance of the payment of dividends to creditors, "and to be paid in full out of bankrupt estates," in the order then stated; it was at least odd to think that a wage claim up to $600 was "paid in full" when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.[4] But the issue did not come before the Supreme Court; and apparently the lower

[4] For the meaning of "paid in full" as limited to the principal, see *Hammer* v. *Tuffy*, *supra*, 145 F. 2d at page 449.

federal courts continued their former practice. *Cf. Horn v. Boone County Neb.*, 8 Cir., 44 F. 2d 920; *In re Semon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States v. Roth, supra*, 164 F. 2d at pages 577, 578: "By the 1938 amendments, however, taxes were classified as 'debts' within section 64, sub. a. 11 U. S. C. A. § 104, sub. a, and section 57, sub. n, 11 U. S. C. A. § 93, sub. n, was broadened to include 'all claims of the United States' and require them to 'be proved and filed in the manner provided in this section.'[5] Subdivision a of section 57, 11 U. S. C. A. § 93, sub. a, provides that a proof of claim shall state among other matters 'that the claim is justly owing from the bankrupt to the creditors'; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which like other creditors, must make proof of claim on a form" prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also.[6] The chief ground taken in *Davis v. Green*,

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[5] In addition, by these amendments the priority subdivision formerly § 64b became § 64a, and the classes or priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) "the fees for the referees' salary fund and for the referees' expense fund." [This note is not a part of the quotation.]

[6] By making a tax claim a debt of the bankrupt it is brought within the terms of § 63a, 11 U. S. C. A. § 103(a), defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, but less costs incurred and interest after the filing. Hence under subd. (5),

supra, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such congressional adoption where "a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the problem was ever under consideration." 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of par. 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to these various state and governmental units "would necessitate constant rescheduling and recomputation of dividends available." 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.[7] Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink v. Unemployment Reserves Commission of State of California*,

when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under § 64a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000 and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or perhaps more) per annum during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland.

314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be eaten up by the accruing interest on the various taxes now levied against business enterprises. As Referee Hunt points out, 17 J. N. A. Ref. Bankr. 121, 122, no trustee can afford to resist any tax claims, even with proper defenses. With interest accruing thus rapidly, he must settle at once and stop the increase in amount. True, it is suggested that this will be a boon to failing debtors who otherwise might be forced to the wall by rapacious tax collectors driven to precipitous action because the claims do not bear interest. But this is based upon an assumption both of alertness upon the part of taxing officials and of the importance of this lone item in the tax structure of municipalities and the state and federal governments which seems to us to have little connection with reality.

Two further arguments of claimants must be noted. One is as to § 57j, an old provision of the law stating that debts owing the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of pecuniary loss sustained "and such interest as may have accrued thereon according to law." Whether this has any meaning beyond the penalty or forfeiture cases we do not need to consider, for it seems clearly to be operable only *after* the question as to what, of any, interest is legal has been decided.[8] The other is that, since tax claims, if unpaid, are not discharged in bankruptcy, then the unpaid interest on tax claims will survive against the bankrupt even after payment of the tax claims themselves. No cases appear yet to have held that interest thus survives beyond the principal claim which gives it birth. But assuming *arguendo* that interest is not discharged upon payment of the tax claim, we do not see

[8] In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state, and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation.

how that fact can be decisive on the present issue. When the Chandler Act was under consideration, the House bill made taxes dischargeable, while the Senate amendment retained existing law. Sen. Rep. No. 1916, 75th Cong., 3d Sess., 4, stated that the committee felt "that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment." Thus this was done to protect the revenue, and consideration for, or against, the bankrupt was not an issue. The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee. The point is academic here—as it will often be—since the bankrupt is a corporation whose existence will be brought to an end by the bankruptcy.

Accordingly the order on appeal will be affirmed to the exent that it refuses to expunge the tax claims, but will be reversed so far as it allows interest after the filing of the petition on January 5, 1944.

Order affirmed in part and reversed in part.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

IN THE MATTER OF
UNION FABRICS, INC.,
Bankrupt,

STATE OF NEW YORK,
Petitioner,

v.

LEONARD H. CARTER, TRUSTEE IN BANKRUPTCY,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

Opinions Below

The opinion of the District Court is reported in 73 Fed. Supp. 685, and is to be found at page 19 of the record. The opinion of the Circuit Court of Appeals for the Second Circuit is to be found at page 41 of the record. It has not been officially reported at the time of the preparation of this brief.

II

Jurisdiction

The date of the judgment to be reviewed is May 25, 1948 (R. 45).

The jurisdiction of this Court is invoked under § 240 of the Judicial Code [28 U. S. C. A. § 347].

III

Statement of the Case

The essential facts of the case are stated in the accompanying petition for a writ of certiorari, and in the interest of brevity are not repeated here.

IV

Specification of Errors

The Circuit Court of Appeals erred in disallowing interest on the tax claims of the State of New York to the date of payment thereof, and in holding that such tax claims carry interest only to the date of the filing of the petition in bankruptcy.

V

ARGUMENT AND AUTHORITIES IN SUPPORT OF PETITION

Summary of the Argument

POINT A

The State of New York is entitled to interest on its claims for franchise and unemployment insurance taxes to the date of payment of the claims. The amendments

to §§ 57 (j), 57 (n) and 64 (a) of the Bankruptcy Act, as contained in the Chandler Act, did not change the previously existing rule that tax claims carry interest to the date of payment.

Point B

Evidence that the trustee in bankruptcy was engaged in litigation over a period of years, which resulted in an increase in the value of the assets of the bankrupt estate, is immaterial on the question whether interest on tax claims is payable to the date of payment. The question presented is one of law and not of equity.

Point A

It cannot be disputed that prior to the amendment of the Bankruptcy Act by the Chandler Act in 1938, tax claims carried interest to the date of payment.

Dayton, Trustee v. *Stannard, Treasurer, etc.* (1946), 241 U. S. 588;

People of the State of New York v. *Jersawit, Trustee* (1923), 263 U. S. 493;

United States v. *Childs* (1924), 266 U. S. 304;

Horn v. *Boon County, Nebraska* (1930, C. C. A. 8), 44 Fed. (2d) 920;

Matter of Beardsley & Wolcott Mfg. Co. (1936, C. C. A. 2), 82 Fed. (2d) 239;

Matter of Martin (1935, C. C. A. 7) 75 Fed. (2d) 618.

It is not apparent from the Chandler Act amendments to § 64 (a) [11 U. S. C. A. § 104 (a)] and § 57 (n) [11 U. S. C. A. § 93 (n)], or from the Congressional Reports or debates on the Chandler Act amendments, that Congress ever intended to change the long established rule with respect to the payment of interest on tax claims. The amendments to those sections were for the purpose of facilitating the prompt and orderly administration of bankrupt estates. Section 57 (j) of the Bankruptcy Act [11 U. S. C. A. § 93 (j)] has remained unchanged since the original bankruptcy

act was passed in 1898, except that the words "state, county, district or municipality" were taken out and the words "or any state or subdivision thereof" inserted in their stead by the Chandler Act. It was under § 57 (j) that this Court held in *United States* v. *Childs*, 266 U. S. 304, that taxes carry interest to the date of payment. In *Medink* v. *Unemployment Reserves Commission of California*, 314 U. S. 564, this Court held that interest at the rate of 12% per annum, as prescribed by the California Unemployment Compensation Act, on California's claim for unemployment compensation taxes was "* * * such interest as may have accrued thereon according to law," within the meaning of § 57 (j), *supra*, and not a penalty within the meaning of that section. The Circuit Court of Appeals for the First Circuit in *Davis* v. *Grech*, 133 Fed. (2d) 451, has also held that the Chandler Act amendments did not change the long existing rule. This latter decision is in direct conflict with the opinion of the Second Circuit Court of Appeals in the instant case, and in *Saper* v. *City of New York*: — Fed. (2d) — (decided May 25, 1948).

That Congress, by the Chandler Act, did not intend any change in the previously existing rule is conclusively shown by the fact that on June 8, 1948, the House of Representatives passed a bill introduced by Congressman Reed (H. R. 5693; 80th Congress, 2d Session), by which it is intended to amend the Bankruptcy Act in several respects. Section 11 of that bill provides for the amendment of § 57 (j) of the Bankruptcy Act to read as follows:

> "Sec. 11. (a) Subdivision j of section 57 of such Act, as amended, is amended to read as follows:
>
> "'j. (1) Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss up to the date of bankruptcy.
>
> "'(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy

on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed.'"

This bill was referred to the Senate Committee on the Judiciary on June 9, 1948, but no action thereon had been taken up to the time of the recent adjournment of Congress.

The introduction of this bill indicates conclusively that the Chandler Act amendments were not intended to deprive the sovereigns of interest on the tax claims to the date of payment. If such had been the previous Congressional intent, an amendment to accomplish that result would have been enacted many years ago, since Congress is presumed to have knowledge of the long line of cases granting such interest.

If this bill becomes law it will not make academic the question presented here, since §31 of the bill provides:

> "Sec. 31. Effect of this Amendatory Act.—(a) Nothing herein contained shall have the effect to release or extinguish any penalty, forfeiture, or liability incurred under any Act or Acts of which this Act is amendatory."

The State of New York, acting within its constitutional sphere, has established the measure of the delinquency of the bankrupt with respect to the franchise and unemployment insurance taxes involved herein. New York Unemployment Insurance Law §570, subd. 3 (Labor Law Art. 18) provides that if an employer shall default in any payments required to be made by him to the unemployment insurance fund before July 1, 1947, interest upon the amount determined to be due shall be payable at the rate of 6% per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund. This is the section which applies to the unemployment insurance taxes involved in this proceeding, since they were payable prior to July 1, 1947, and covered the period January 1, 1936 to November 28, 1939. A copy of §570, subds. 1-4 of the New York Unemployment Insurance Law is attached hereto as an appendix.

Similarly, the Legislature of New York has established the measure of delinquency of the bankrupt with respect to franchise taxes, as set forth in New York Tax Law 213, copy of which is appended hereto. Accordingly, the State of New York is entitled to interest to the date of payment of the tax claims, since Bankruptcy Act 57(j) provides for the payment of "such interest as may have accrued thereon according to law." Interest has accrued on these claims according to the law of the State of New York.

Point B

The District Court, in reversing the order of the referee herein, held that the referee should have considered the equities presented by the record in determining whether interest should be allowed to the date of payment (R. 25), and that "the allowance of interest to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable and to result in an unbalance of equities between the several creditors rather than a 'balance of equities' which the Supreme Court says is the touchstone of each decision."

This statement was apparently prompted by the language of this court in *Vanston Bondholders Protective Committee v. Green, et al.*, 329 U. S. 156. In that case tax claims were not involved. The question presented there was whether the creditors holding first mortgage bonds, which provided for the payment of "interest on interest" should receive such interest. If so, subordinate creditors would receive a greatly reduced share in the reorganized corporation. This court held that the imposition of "interest on the unpaid interest" cannot be justified by an application of equitable principles. These subordinate creditors, however, conceded that the holders of the first mortgage bonds should receive simple interest on the principal due them.

There is no question here that the State's claims were filed timely, nor is there any assertion that any action or inaction on the part of the State caused a delay in the payment of claims. The claims were filed in 1940. The assets of the estate, prior to the receipt of the sum of $30,000 in

settlement of the claim of the trustee against the bankrupt's former president, were $19,888.11 in cash and a small amount of merchandise (R. 8). This was more than sufficient to pay the entire priority claims of the United States and the State of New York in the principal sum of $11,526.27 (R. 7), with interest which had accrued to the time of the filing of the claims, amounting to $1,233.59, as well as the amount which was paid to the City of New York in compromise of its tax claim in the sum of $3,564.70, amounting in all to the sum of $16,324.56. After the payment of these tax claims, there would have still remained in the estate the sum of $3,563.55. The trustee, however, chose to let these tax claims remain unpaid until the litigation, which lasted approximately six years, was concluded (R. 6-8). Under these circumstances, there is nothing in this case to charge the State with the delay in payment of its claims and thus justify the court in denying interest on asserted equitable grounds.

In *Pepper* v. *Litton*, 308 U. S. 295, this Court held that bankruptcy courts have certain equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. "These [these equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical consideration will not prevent substantial justice from being done" (p. 304). The instant case, so far as the tax claims are concerned, does not fall within any of these categories to which bankruptcy courts may apply equitable powers. Courts may not invoke "a balance of equities" when such action would be clearly contrary to the statutory mandate (*New Jersey* v. *Anderson*, 203 U. S. 483, 490).

Conclusion

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory power. The subject matter of this petition is of great importance because it affects the administration of innumerable bankrupt estates. If the conflict in opinion between the Circuit Courts of Appeals for the First and Second Circuits continues to exist, the expeditious closing of many bankruptcy

proceedings will be forestalled by the uncertainty created thereby. This Honorable Court should resolve this difference of opinion so that bankruptcy referees throughout the country will have no uncertainty as to the law on the subject.

Dated, July 13, 1948.

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APPENDIX

New York Tax Law §213:

"* * * If any part of any tax imposed by this article is not paid when due, the taxpayer shall pay to the tax commission, in addition to the amount of such tax, five per centum of such unpaid amount, plus one per centum for each month the tax remains unpaid. The tax commission in its discretion may modify the penalties or additional amounts provided in this article without regard to whether such penalties or additional amounts have been included in a statement of account or an application for revision of such account has been filed."

New York State Unemployment Insurance Law (Labor Law, Artice 18)—§570, subds. 1, 2, 3 and 4:

"Payment of Contributions. 1. Rate. Each employer liable under this article shall pay regularly contributions in an amount equal to two and seven-tenths per centum of his payroll.

"2. Time and method of payment. Contributions shall become payable by any employer for wages paid on and after the date on which he becomes liable under this article. All contributions from employers shall be paid at such times and in such manner as the commissioner may prescribe.

"3. Default before July first, nineteen hundred forty-seven. If an employer shall default in any payments required to be made by him to the fund before July first, nineteen hundred forty-seven, interest upon the amount determined to be due from the employer shall be payable upon notice and demand from the commissioner at the rate of six per centum per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund.

"If any part of any deficiency in payment of the employer's contribution to the fund before July first, nineteen hundred forty-seven is due to negligence but

without intent to defraud, five per centum of the total amount of the deficiency, in addition to such deficiency, shall be assessed, collected, and paid in the same manner as if it were a deficiency.

"4. Default on and after July first, nineteen hundred forty-seven. An employer who fails to pay contributions required to be made by him to the fund on or after July first, nineteen hundred forty-seven, shall pay interest at the rate of three-fourths of one per centum of the amount of such contributions for each month, or fraction thereof, he is in default. Such interest shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund."